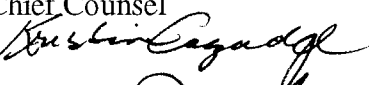
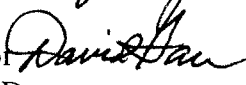


Memorandum

To: Honorable John Chiang, Chair
Honorable Claude Parrish, Vice-Chairman
Honorable Betty T. Yee, Acting Board Member
Honorable Bill Leonard
Honorable Steve Westly

Date: December 5, 2006

From: Kristine Cazadd, Chief Counsel
Legal Department 

David Gau, Deputy Director 
Property and Special Taxes Department

Subject: **RECENT FEDERAL DEVELOPMENTS & EMERGENCY TELEPHONE USERS
(911) SURCHARGE REFUND REQUESTS**

INTRODUCTION

This memorandum summarizes recent federal developments that have and will continue to precipitate claims for refund under the Emergency Telephone Users (911) Surcharge Law. For the reasons stated below, the Legal Department does not believe these recent federal developments provide a sufficient basis for granting 911 surcharge refund claims. Finally, this memorandum discusses potential actions that may be taken to clarify that the 911 Surcharge Law is unaffected by these recent federal developments.

BACKGROUND INFORMATION

The Legislature enacted the 911 Surcharge Law in 1976 (operative July 1, 1977) to provide funding in support of the 911 telephone system in this state. The funds generated by the 911 surcharge (911 Account) are primarily used to: (1) maintain the 911 database and network; (2) replace or upgrade 911 phone equipment and related software at approximately 500 Public Safety Answering Points (PSAPs) across the state (i.e., reimburse police, sheriff and fire departments for 911 phone equipment purchases); (3) fund the answering of the approximately 8 million cellular 911 calls the California Highway Patrol receives each year (and the transferring of these calls to the closest PSAP, as appropriate); and (4) fund the administration of the 911 surcharge by the Board and the processing of PSAP and other reimbursement claims by the Department of General Services (DGS). Over the last five fiscal years, the Board has collected, on average, approximately 130 million dollars per fiscal year in 911 surcharge revenue. Over this same period, including transfers from retained earnings from prior years, DGS has expended approximately 140 million dollars per fiscal year from the 911 Account. For the current fiscal year, DGS projects that it will expend approximately 160 million dollars to provide vital and

essential funding for law enforcement and public safety purposes related to the 911 telephone system in California.

Subject to certain exemptions that are not relevant to this discussion, when it enacted the 911 Surcharge Law in 1976, the Legislature intended to fund the 911 Account by imposing the 911 surcharge on all charges for intrastate telephone services, both local (or general) service and intrastate long distance service. Apparently for the sake of convenience, the Legislature appropriated an existing federal definition of long distance (or toll) telephone service, which accurately reflected industry billing practices in 1976. Specifically, the Legislature defined “toll telephone service” (i.e., long distance service) as “[a] telephonic quality communication for which . . . there is a toll charge which varies in amount with the distance *and* elapsed time of each individual communication . . .” (Rev. & Tax. Code, § 41016, subd. (a)(1) [emphasis supplied]; cf. 26 U.S.C.A. § 4252(b)(1)(A).) Because the Legislature’s intent was to impose the 911 surcharge on all intrastate telephone charges, it does not appear reasonable to construe the word “and” in the definition (highlighted above) as having a conjunctive meaning. A conjunctive meaning would result in only intrastate long distance charges that are measured by both distance and time being subject to the 911 surcharge.

Simply put, given the intended surcharge base established by the Legislature, the Legal Department believes it is highly unlikely that the Legislature intended to suggest to long distance service suppliers that they could avoid their obligation to collect the 911 surcharge on their intrastate long distance charges by merely changing their billing practices to measure these charges either only by distance or only by time. As the California Supreme Court has held: “The inadvertent use of ‘and’ where the purpose or intent of a statute seems clearly to require ‘or’ is a familiar example of a drafting error which may properly be rectified by judicial construction.” (*People v. Skinner* (1985) 39 Cal.3d 765, 775.)¹ It is the opinion of the Legal Department that, in light of the purpose and intent of the 911 Surcharge Law, the “and” in question was used inadvertently and should be construed to have a disjunctive meaning (i.e., to mean “or”). A disjunctive meaning would effectuate the legislative intent to impose the 911 surcharge on all intrastate long distance charges, as well as on all charges for local (or general) telephone service.

For reasons wholly unrelated to the imposition of the 911 surcharge, changes in the telecommunications industry since 1976 have caused long distance service suppliers to change their billing practices. The current predominant industry practice is to measure all domestic long distance charges (both intrastate and interstate) by only elapsed time. For the reasons stated above, the Legal Department believes that this change in industry billing practices has no effect on the imposition of the 911 surcharge. However, as discussed below, the U.S. Treasury

¹ Similarly, the United States Supreme Court explained, in *United States v. Fisk* (1865) 70 U.S. 445: “In the construction of statutes, it is the duty of the court to ascertain the clear intention of the legislature. In order to do this, courts are often compelled to construe ‘or’ as meaning ‘and’ and again ‘and’ as meaning ‘or.’” (*Id.* at p. 447 [emphasis in original].)

Department has recently reached a different conclusion with respect to that portion of the federal excise tax on telephone services that is imposed on toll (i.e., long distance) telephone service.

RECENT FEDERAL DEVELOPMENTS

The federal excise tax on telephone services, which is administered by the Internal Revenue Service (IRS), is imposed on certain local and long distance (toll) telephone services. This federal tax was originally enacted in 1898 to pay for expenses related to the Spanish-American War but was later extended to provide a source of general revenue for the federal government. As discussed above, although enacted for an entirely distinct purpose and with a completely different legislative intent, California's definition of "toll telephone services" derives from the federal definition. (See 26 U.S.C.A. § 4252(b)(1)(A).)

When industry practices shifted to billing long distance charges solely on the basis of elapsed time, various taxpayers initiated federal refund challenges to that portion of the federal excise tax imposed on long distance charges. As a result of these challenges, five federal appellate courts (2nd, 3rd, 6th, 11th, and D.C. Circuits) determined in 2005 and 2006 that, for purposes of the federal excise tax, the "and" in the definition of "toll telephone services" should be construed to have a conjunctive meaning, thus resulting in the granting of the subject refund claims. (See, e.g., *American Bankers Insurance Group v. U.S.* (11th Cir. 2005) 408 F.3d 1328.) In response to these litigation losses, on June 19, 2006, the IRS released a notice (which confirmed an earlier press release) stating that it was acquiescing to the holdings of the five Court of Appeal cases. (See IRS Notice 2006-50.) This acquiescence does not affect the imposition of the federal excise tax on local telephone service (or, presumably, on long distance charges that are measured by both distance and time). As a result of the IRS notice, since August 1, 2006, long distance service suppliers have not been required to collect the federal excise tax on time-only long distance charges.

As stated above, the Legal Department does not believe that these recent federal developments have any direct effect on the 911 Surcharge Law. Since its enactment in 1976, both Board staff and the staff of the Department of General Services have consistently interpreted the "and" of the California statute in question to have a disjunctive meaning (i.e., to mean "or") and have administered every aspect of the 911 Surcharge program in a manner consistent with this interpretation.

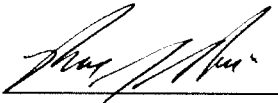
POTENTIAL ACTION ITEMS

To the extent the Board were to decide that, in light of the recent federal developments, further clarification of the application of the 911 surcharge to intrastate long distance charges would be helpful to the service users and service providers of California, the Board may want to consider supporting corrective legislative language to rectify the inadvertent "and" in question. Specifically, staff is preparing an agenda item for the Board's January 31, 2007, Legislative Committee meeting that will propose that the pertinent "and" in Revenue and Taxation Code section 41016, subdivision (a)(1), be changed to "or," with the inclusion of a noncodified section specifying that the proposed statutory change is declaratory of existing law.

Furthermore, as indicated above, the Board has already received one claim for refund, dated September 25, 2006, asserting that the "and" in question should be construed conjunctively (citing the recent federal developments), and likely will receive many more. For the reasons stated above, unless directed otherwise, the Legal Department intends to advise the Excise Taxes and Fees Division to deny this and any similar refund claims and to inform service suppliers that the recent federal developments do not affect their 911 surcharge collection obligations.

If you have any questions or would like additional information pertaining to this issue, please contact me at 445-4830 or Deputy Director David Gau at 445-1516.

KC/ef

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